

**Processing Changes Would Enhance Service
to Taxpayers Filing Amended U.S.
Corporation Income Tax Returns**

August 2003

Reference Number: 2003-30-169

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

August 19, 2003

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Assistant Inspector General for Audit (Small Business and
Corporate Programs)

SUBJECT: Final Audit Report – Processing Changes Would Enhance
Service to Taxpayers Filing Amended U.S. Corporation Income
Tax Returns (Audit # 200230055)

This report presents the results of our review to determine if the Internal Revenue Service's (IRS) Submission Processing Sites are properly identifying Amended U.S. Corporation Income Tax Returns (Form 1120X) that meet certain criteria and forwarding them to other functional areas for processing, and correctly processing the remaining amended returns.

Corporations submit Forms 1120X primarily to correct income tax returns previously filed. Tax Examiners (TE) in the Submission Processing Sites' Code and Edit functions screen Forms 1120X to identify those meeting the criteria for referral to other functions where more complex issues are handled, those that need to be returned to the taxpayers for additional information, and those that can be processed at the Submission Processing Site.

In summary, although most adjustments to taxpayers' accounts were processed as reported by the taxpayers on Forms 1120X, cases worked in the Submission Processing Sites were not always worked in the most efficient manner or did not fully resolve taxpayers' accounts. TEs sometimes: 1) made incorrect tax adjustments or interest computations; 2) overlooked documents attached by taxpayers for processing; 3) sent inaccurate notices to taxpayers; and 4) did not address misapplied payments, discrepancies in credits claimed, filing requirements, elections and address changes.

These errors occurred for several reasons. Guidelines did not instruct these TEs to compare payments, income, and tax shown on Forms 1120X with data in taxpayers'

accounts, and guidelines for referring cases to other functions were incomplete. In addition, TEs at the Cincinnati Submission Processing Site did not have access to terminals for the Integrated Data Retrieval System (IDRS),¹ which contains taxpayers' account information. Consequently, they did not search for conditions in taxpayers' accounts that would require the Forms 1120X be referred to other functions, and could not verify data on the Forms 1120X.

As a result, the Submission Processing Sites did not resolve some accounts either accurately or completely, generating some refunds in error or unnecessarily delaying others, requiring the Federal Government to pay interest unnecessarily, and making some taxpayers correspond unnecessarily with the IRS to get their accounts corrected. Specifically, a refund was erroneously processed, but stopped before issuance, for over \$1 million because information on the Form 1120X was not compared to information in the taxpayer's account; over \$1 million was refunded in cases that should have been referred to the Examination function;² and refunds were delayed in 12 accounts. Further, over \$1 million in interest was unnecessarily refunded or caused to be refunded because cases were not referred to the Accounts Management (AM) Adjustment function; and actions unnecessarily caused some type of additional interaction with taxpayers in 40 cases.

Additionally, the Cincinnati Submission Processing Site did not code Forms 1120X accounts when the Forms were referred to the Examination function for processing. IRS procedures require this coding to establish a record that the claims were filed and referred to the Examination function; however, local Submission Processing Site management did not ensure that the procedures were followed.

We recommended that the Director, Customer Account Services (CAS), Small Business/Self-Employed Division, ensure that Forms 1120X are processed in CAS where the TEs have access to IDRS and the skill set necessary to recognize and resolve all related issues affecting the taxpayers' accounts. However, if the Submission Processing Sites' Code and Edit functions continue to process Forms 1120X, they should follow the same processing guidelines as the AM Adjustment function and refer all Forms 1120X that exceed their capabilities to that function for processing. The TEs in the Code and Edit functions in the Cincinnati Submission Processing Site would require access to and training on the use of the IDRS. In addition, the Director, CAS, should ensure the proper coding of accounts of Forms 1120X referred to the Examination function.

Management's Response: IRS management agreed that processing changes need to be made to enhance the IRS' service to taxpayers filing Forms 1120X and is taking steps to implement our recommendations. Discussions will be held to determine

¹ IDRS is an IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

² The IRS' Accounts Management Adjustment function changes taxpayer accounts based on information it receives from taxpayers and other IRS departments. The Examination function reviews tax returns to ensure they comply with the tax laws.

whether to place the processing of Forms 1120X in Submission Processing or the AM Adjustment function. After this determination is made, the Internal Revenue Manual will provide procedural guidance for the processing of these amended returns. The IRS will ensure that proper IDRS research training is provided to the CAS employees working this program. In addition, procedures will reflect the input of the appropriate action code prior to referring the Forms 1120X to the Examination function. Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Parker F. Pearson, Director (Small Business Compliance), at (410) 962-9637.

**Processing Changes Would Enhance Service to Taxpayers Filing
Amended U.S. Corporation Income Tax Returns**

Table of Contents

Background	Page 1
Some Taxpayers Did Not Receive Quality Service When Their Amended U.S. Corporation Income Tax Returns Were Processed in the Submission Processing Sites	Page 2
<u>Recommendations 1 and 2:</u>	Page 5
The Cincinnati Submission Processing Site Is Not Coding the Accounts of Forms 1120X Referred to the Examination Function	Page 6
<u>Recommendation 3:</u>	Page 6
Appendix I – Detailed Objective, Scope, and Methodology	Page 7
Appendix II – Major Contributors to This Report.....	Page 9
Appendix III – Report Distribution List	Page 10
Appendix IV – Outcome Measures	Page 11
Appendix V – Results of Case Review	Page 12
Appendix VI – Management’s Response to Draft Report	Page 14

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

Background

Amended U.S Corporation Income Tax Returns (Form 1120X) are filed by corporate taxpayers primarily to correct income tax returns previously filed. Forms 1120X are generally received throughout the year by the Internal Revenue Service's (IRS) Submission Processing Sites.

Forms 1120X can contain a wide variety of issues, from the complex to the elementary. For example, one claim filed on Form 1120X can be for a refund in excess of \$10 million while another can be a protective claim, filed by a corporation only to hold the statute of limitations open to receive some future benefit. Some require special interest computations. It is important that the IRS function processing the Forms 1120X has sufficient expertise in the issues contained on the forms.

Employees in the Submission Processing Sites' Code and Edit functions screen Forms 1120X to identify those meeting criteria for referral to other functions¹ where more complex issues are handled, those that need to be returned to taxpayers for additional information, and those that can be worked within the Submission Processing Site. When Forms 1120X are referred to a function outside of Submission Processing or returned to taxpayers, accounts are coded to establish a record that the form was referred to that function or returned to the taxpayers.

Forms 1120X that do not meet the criteria to be transferred or returned to taxpayers continue to be processed in the Submission Processing function. Within the Submission Processing function, any adjustments to taxpayers' accounts as a result of the Forms 1120X may be processed in one of two ways, as determined by local management. The first method, used in the Ogden Submission Processing Site, requires employees in the Code and Edit functions to enter adjustments directly to taxpayers' accounts using the

¹ The IRS' Accounts Management Adjustment function changes taxpayer accounts based on information it receives from taxpayers and other IRS departments. The Collection function secures past due payments and returns. The Statute Control function addresses issues regarding the Statute of Limitations. The Examination function reviews tax returns to ensure they comply with the tax laws.

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

Integrated Data Retrieval System (IDRS).² The other method, used in the Cincinnati Submission Processing Site, requires Forms 1120X to be forwarded to another function within Submission Processing, called Data Conversion, where the adjustment information is entered onto computer tapes, which are later transmitted to the IRS' Business Master File³ to update taxpayers' accounts.

The Submission Processing Sites received over 41,000 Forms 1120X from January 2001 through June 2002. They adjusted 16,438 corporate accounts during Calendar Year (CY) 2001 and the first half of CY 2002. During that same period, they referred 24,854 Forms 1120X to the Accounts Management (AM) Adjustment function.

We performed this audit at the Brookhaven Campus⁴ from October 2002 through February 2003. Our audit work included cases received in the Ogden and Cincinnati Submission Processing Sites. The audit was performed in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Some Taxpayers Did Not Receive Quality Service When Their Amended U.S. Corporation Income Tax Returns Were Processed in the Submission Processing Sites

Two major strategies in the IRS' Strategic Plan for Fiscal Years 2000-2005 are meeting the needs of the taxpayer and reducing taxpayer burden. The first calls for first-quality service whenever the IRS deals with the taxpayer. The second calls for addressing taxpayer problems as early in the process as possible.

Even though most adjustments to taxpayers' accounts were processed as reported by the taxpayer on Form 1120X, we found that many of the cases worked in the Submission

² The IDRS is an IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

³ This is the IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

⁴ The campuses are the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

Processing Sites were not worked in the most efficient manner or did not fully resolve taxpayers' accounts. We reviewed 202 Forms 1120X cases⁵ processed by the Submission Processing Sites' functions and found that 88 were not properly resolved. The errors we found included the following:

- Incorrect tax adjustments or incorrect interest calculations (26 cases).
- Documents attached by taxpayers for processing overlooked by the IRS (five cases).
- Inaccurate notices sent to taxpayers (seven cases).
- Misapplication of payments, discrepancies in credits claimed, and requests for credit elects not addressed (25 cases).
- Filing requirements, elections to forego net operating loss carrybacks, address changes, U.S. Corporation Income Tax Returns (Form 1120) that should be reprocessed to the correct tax period, or employer identification number not addressed (11 cases).
- Forms 1120X not properly processed, but no immediate impact to the taxpayers or the IRS (14 cases).

For a complete description of the error cases, see Appendix V.

These errors occurred for several reasons:

- Instructions provided to the Code and Edit functions' Tax Examiners (TE) in the Submission Processing Sites do not require them to compare payments, income, and tax shown on the Forms 1120X with account information on IRS computers. In contrast, this research is required of employees in the AM Adjustment function that process Forms 1120X, and a recent update of procedures for processing Amended U.S. Individual Income Tax Returns (Form 1040X) requires employees in the Code and Edit functions to perform this research

⁵ We used a judgmental sample. See Appendix I for details concerning our sample selection.

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

when processing Forms 1040X. Verifying data on Forms 1120X to account information would help to prevent incorrect tax adjustments and enable TEs to identify problems that might need resolution at the same time the Forms 1120X are processed.

- Information required in Form 1120X notices issued to taxpayers by the Code and Edit functions differs from the information required in notices issued by other functions processing these forms.
- Criteria provided to the Code and Edit functions' TEs for referring cases to other functions with more technical expertise do not include all circumstances that it should. For example, when payments received with Forms 1120X are misapplied, TEs should ensure that the payments are corrected before tax adjustments are made to the accounts.
- TEs in the Code and Edit functions at the Cincinnati Submission Processing Site did not have access to IDRS terminals.⁶ Without access to the IDRS, these employees cannot directly access taxpayer account information to search for conditions on the taxpayer's account that would require the Form 1120X to be referred to another function (such as an ongoing examination), or to verify data on the Form 1120X.

As a result, some refunds were generated in error or were unnecessarily delayed, the Federal Government was required to pay interest unnecessarily, and some taxpayers were unnecessarily required to correspond with the IRS to get their accounts corrected. In the 88 accounts that were not properly resolved or referred:

- A refund for over \$1 million was erroneously processed, but was stopped before issuance, because information on Form 1120X was not compared to information in the taxpayer's account.

⁶ The clerical staff has access to the IDRS. The TE can request the clerical staff to research an item such as a missing tax period, but they do not review all accounts.

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

- Over \$1 million was refunded in cases that should have been referred to the Examination function.
- Refunds were delayed in 12 accounts.
- Over \$1 million in interest was unnecessarily refunded or caused to be refunded because cases were not referred to the AM Adjustment function.
- Actions unnecessarily caused some type of additional interaction with taxpayers in 40 cases.

Recommendations

The Director, Customer Account Services (CAS), Small Business/Self-Employed (SB/SE) Division, should ensure that:

1. Forms 1120X are processed in a function of the CAS where the TEs have access to the IDRS and the skill set necessary to recognize and resolve all related issues affecting the taxpayers' accounts.

Management's Response: The Directors of AM and Submission Processing will meet to decide whether to place the processing of Forms 1120X in Submission Processing or the AM Adjustment function. After this determination is made, the Internal Revenue Manual will provide procedural guidance for the processing of these amended returns including IDRS activity.

2. If the Submission Processing Sites' Code and Edit functions continue to process Forms 1120X, they should follow the same processing guidelines as the AM Adjustment function and refer Forms 1120X to the AM Adjustment function for processing when they do not have the capabilities to process all necessary corrections to the Form 1120X accounts. This would necessitate access to and training on the use of the IDRS for the TEs in the Cincinnati Submission Processing Site's Code and Edit functions.

Management's Response: The Director, CAS, will ensure procedures are followed that refer Forms 1120X to the AM Adjustment function when appropriate. Additionally, the

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

The Cincinnati Submission Processing Site Is Not Coding the Accounts of Forms 1120X Referred to the Examination Function

IRS will ensure that proper IDRS research training is provided to CAS employees working this program.

The Cincinnati Submission Processing Site is not coding the accounts of Forms 1120X when the forms are referred to the Examination function. IRS procedures require entering to each account a specific code (action code) that establishes a record that the amended return was referred to the Examination function. However, local Submission Processing Site management did not ensure that the procedures were followed. Without the coding, taxpayer inquiries regarding the Forms 1120X cannot be properly resolved.

Further, IRS employees would not be able to determine that the Forms 1120X were referred to the Examination function until the Forms are entered on the Examination inventory system. If the accounts were already open in the Examination function when the Forms 1120X were filed, it is impossible for the IRS to identify the filing of the Form 1120X, unless the taxpayers' accounts are properly coded.

Recommendation

3. The Director, CAS, should ensure that when Submission Processing Sites refer Forms 1120X to the Examination function, the appropriate action code is processed to each account to establish a record of the referral.

Management's Response: The Director, CAS, will ensure that procedures reflect the input of the appropriate action code prior to referring the Forms 1120X to the Examination function.

**Processing Changes Would Enhance Service to Taxpayers Filing
Amended U.S. Corporation Income Tax Returns**

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine if the Submission Processing Sites are properly identifying Amended U.S. Corporation Income Tax Returns (Form 1120X) that meet certain criteria and forwarding them to other functional areas for processing; and correctly coding, editing and processing the remaining amended returns timely, or contacting taxpayers for necessary information.

In order to accomplish our objective, we:

- I. Determined whether Submission Processing Sites properly identified Forms 1120X that met criteria for routing to the Examination function.
 - A. Reviewed Internal Revenue Manuals (IRM) relating to the processing of Forms 1120X and the criteria for identifying returns for examination.
 - B. Reviewed a judgmental sample 202 cases, including the related Forms 1120X (in 194 cases), processed in Submission Processing Sites during Calendar Year (CY) 2001 and the first half of CY 2002 to determine whether the Forms 1120X met the criteria for referral to the Examination function and were properly handled. Reviewed a judgmental sample rather than a statistical sample to allow a greater range of review. See III. C. for additional details of the case selection.
- II. Determined whether Submission Processing Sites properly identified Forms 1120X that met the criteria for routing to the Accounts Management (AM) Adjustment function.
 - A. Reviewed IRMs relating to the processing of Forms 1120X and the criteria for identifying returns to be forwarded to the AM Adjustment function.
 - B. Reviewed a judgmental sample of 202 cases of Forms 1120X processed in Submission Processing Sites during CY 2001 and the first half of CY 2002 to determine whether the Forms 1120X met the criteria for referral and were correctly referred to the AM Adjustment function.
- III. Determined whether Submission Processing Sites correctly processed Forms 1120X in a timely manner.
 - A. Researched for any prior General Accounting Office and Treasury Inspector General for Tax Administration reports regarding the processing of Forms 1120X.
 - B. Reviewed IRMs relating to the processing of Forms 1120X.

**Processing Changes Would Enhance Service to Taxpayers Filing
Amended U.S. Corporation Income Tax Returns**

- C. Scanned accounts of adjustments processed by all the Submission Processing Sites during CY 2001 and the first half of CY 2002 to determine the types of errors and issues to be addressed. Using this method, we were able to determine other criteria for referral that should be included in the Submission Processing procedures based on the effect on these accounts. We performed an in-depth review of 202 accounts and the related Forms 1120X (in 194 cases) to determine whether all required information was received from the taxpayers, the adjustments were correct, the statuses of the taxpayers' accounts were correct, and all appropriate issues were addressed. We judgmentally selected the 202 cases for review as follows: We reviewed 19 of the first 56 accounts in a database of 285 accounts where the tax was increased based on Forms 1120X at 1 site. We reviewed the 19 cases because there was some indication of a processing problem. We reviewed another 183 Forms 1120X from other databases of Forms 1120X processed by the Submission Processing Sites in a similar manner.
- D. Determined whether each Form 1120X reviewed pertained to a Large and Mid-Size Business Division account or a Small Business/Self-Employed Division account, and whether the original return filed was a U.S. Income Tax Return for an S Corporation (Form 1120S).
- E. Reviewed the accounts of all Forms 1120X processed with tax decreases by the Cincinnati and Ogden Submission Processing Sites. Determined the additional interest paid to taxpayers for cases where the processing time exceeded 45 days.
- F. Interviewed staff in the Code and Edit functions to determine whether any problems had been identified or recent processing changes had been made.
- G. Interviewed staff in the Unpostable function (a function responsible for resolving transactions that could not be posted to taxpayers' accounts) to determine whether there was a high rate of unpostables from Form 1120X adjustments processed in Submission Processing Sites.

**Processing Changes Would Enhance Service to Taxpayers Filing
Amended U.S. Corporation Income Tax Returns**

Appendix II

Major Contributors to This Report

Richard J. Dagliolo, Director
Parker F. Pearson, Director
Kyle R. Andersen, Acting Director
Robert K. Irish, Audit Manager
John Chiappino, Acting Audit Manager
Dolores Castoro, Senior Auditor
Stephen Wybaillie, Auditor

**Processing Changes Would Enhance Service to Taxpayers Filing
Amended U.S. Corporation Income Tax Returns**

Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner for Services and Enforcement N:SE
Acting Deputy Commissioner, Small Business/Self-Employed Division S
Director, Customer Account Services, Small Business/Self-Employed Division S:CAS
Director, Communications and Liaison, Small Business/Self-Employed Division S:M:CL
Staff Assistant, Small Business/Self-Employed Division S
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M
Audit Liaison: Commissioner, Small Business/Self-Employed Division S

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Revenue protected – Actual; \$1,271,731.21; 7 taxpayer accounts affected (see page 2).
- Increased revenue – Actual; \$2,238.10; 4 taxpayer accounts affected (see page 2).
- Funds put to better use – Actual; \$1,127,361.22 (see page 2).
- Taxpayer rights and entitlements – Actual; 12 taxpayer accounts affected (see page 2).
- Taxpayer burden – Actual; 40 taxpayer accounts affected (see page 2).

Methodology Used to Measure the Reported Benefit:

In our judgment sample of 202 cases,¹ we identified 7 cases with erroneous refunds totaling \$1,271,731.21 and 4 cases in which tax totaling \$2,238.10 was incorrectly abated or not assessed. Also, we found that in 10 cases interest totaling \$1,127,361.22 could have been avoided. In addition, 12 refunds were delayed, and 40 taxpayers had additional interaction with the Internal Revenue Service that could have been avoided.

¹ See Appendix I for details of the sample selection.

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

Appendix V

Results of Case Review

We reviewed 202 Amended U.S. Corporation Income Tax Return (Form 1120X) cases processed by the Submission Processing Sites.¹ We found that the following 88 cases were not properly resolved:

- In nine cases, the request for a credit elect or reduction of a penalty was not addressed. Eight taxpayers requested that the overpayments be applied to the following tax year (credit elect), but the overpayments were instead erroneously refunded. Four of these taxpayers returned the refund checks, but the Internal Revenue Service (IRS) paid interest in excess of \$10,000 on the other four refunds. One taxpayer requested a reduction of the estimated tax penalty, but the penalty was not addressed. The taxpayer had to make a second request for abatement of the penalty.
- In nine cases, filing requirements, address changes, and U.S. Corporation Income Tax Returns (Form 1120) in the wrong accounts were not addressed. In five cases in which filing requirements were not addressed, Tax Delinquency Investigations were initiated erroneously for two taxpayers, and two other taxpayers were treated as Subchapter S Corporations, paying no corporate tax, even though they were not allowed to file Subchapter S returns until the following tax year. Addresses were not changed in two cases. In two other cases, because returns were not reprocessed, taxpayers were charged penalties erroneously.
- In 19 cases, incorrect adjustments were made to the taxpayers' accounts. In three of the cases, tax adjustments were made to the wrong tax year, one of which was later corrected to allow for another adjustment. Multiple adjustments were made erroneously in 2 cases, and taxes were adjusted incorrectly in 12 cases. Two cases should have been referred to the Examination function; 1 of these 2 cases was a protective claim erroneously processed for a refund in excess of \$1 million, and had an unprocessed Form 1120X attached that was for a year in which the statute of limitations is currently expired. Some

¹ As described in Appendix I, we used judgmental sampling of Forms 1120X processed by the Submission Processing Sites. We reviewed 194 Forms 1120X and 8 other accounts where the Form 1120X was not required to determine the error, to make up our 202 cases reviewed. We manually scanned adjustments processed by all the Submission Processing Sites to determine the types of errors and issues that needed to be addressed. We selected the 202 cases for review as follows: We reviewed 19 of the first 56 accounts in a database of 285 accounts where the tax was increased based on Forms 1120X at 1 site. We reviewed the 19 cases because there was some indication of a processing problem and found that 15 of them were not properly resolved. We reviewed another 183 Forms 1120X from other databases of Forms 1120X processed by the Submission Processing Sites in a similar manner and found that 73 were not properly resolved.

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

errors were never detected, and others created additional unnecessary interaction with the taxpayers.

- In eight cases, Forms 1120X were incorrectly processed without restricting the interest and/or disallowing the loss or election. Two of 5 cases processed with the incorrect interest were subsequently corrected, but in 1 case the IRS must attempt to collect back interest in excess of \$600,000. One of the five should have been disallowed entirely. In the remaining three cases, a loss carried forward reducing tax and two untimely elections should have been disallowed.
- In five cases, we found six unprocessed documents attached to Forms 1120X. These documents included two additional Forms 1120X, three Forms 1120, and a Corporation Application For Tentative Refund (Form 1139). When the Treasury Inspector General for Tax Administration forwarded the Form 1139 for processing, the taxpayer, who had been issued erroneous notices for the Form 1120X balance due amount, was issued a refund that included interest in excess of \$400,000, all of which could have been avoided.
- In 17 cases, misapplied payments and errors in credits claimed were not addressed. In 8 of the 17 cases, refunds were delayed because the payment made for the original return had either been misapplied or not claimed by the taxpayer on the original Form 1120. In the other nine cases, the payments received with Form 1120X were misapplied, causing incorrect notices to be issued. A refund was returned because it included one of the misapplied payments.
- In seven cases, notices were not customized to prevent additional, unnecessary interaction with the taxpayer.
- In 14 cases, the Forms 1120X were not properly processed, but there was no immediate impact to the taxpayers or the IRS.

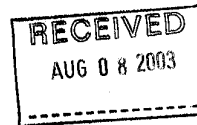
Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224



AUG - 8 2003

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Dale F. Hart *Deleted by MSU/1.2*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report - Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns (Audit #200230055)

I have reviewed your report and agree we must make processing changes to enhance service to taxpayers filing Amended U.S. Corporation Income Tax Returns (Forms 1120X). Due to the procedural and related Integrated Data Retrieval System (IDRS) issues identified in your report, we are reviewing our organization to determine where we should place this program.

Our comments to the recommendations are as follows:

RECOMMENDATION 1

The Director, Customer Accounts Services (CAS), Small Business/Self-Employed (SB/SE) Division should ensure that Forms 1120X are processed in a function of CAS where the TEs have access to the IDRS and the skill set necessary to recognize and resolve all related issues affecting the taxpayers' accounts.

CORRECTIVE ACTION

We are deciding whether to place the processing of Forms 1120X in Submission Processing or Accounts Management. The Directors of Accounts Management and Submission Processing will meet to discuss this issue. If the Forms 1120X processing remains in Submission Processing, we will issue an update to the IRM, which will outline the procedures for handling and processing these forms. If we move the processing to the Accounts Management function, the procedures contained in IRM 21.1 already provide procedural guidance including IDRS activity on these amended returns.

IMPLEMENTATION DATE

February 1, 2004

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

RESPONSIBLE OFFICIAL

Director, Customer Account Services, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

The Director, Customer Accounts Services (CAS), Small Business/Self-Employed (SB/SE) Division, should ensure that if the Submission Processing Sites' Code and Edit functions continue to process Forms 1120X, they should follow the same processing guidelines as the Accounts Maintenance (AM) Adjustment function and refer Forms 1120X to the AM Adjustment function for processing when they do not have the capabilities to process all necessary corrections to the Form 1120X accounts. This would necessitate access to and training on the use of the IDRS for the TEs in the Cincinnati Submission Processing Site's Code and Edit function.

CORRECTIVE ACTION

The Director, Customer Account Services, SB/SE Division will ensure procedures are followed that refer Forms 1120X to AM Adjustments when appropriate. If this process is placed in Accounts Management, all Forms 1120X will be routed directly to the AM Adjustments function for resolution. However, if the process remains in Submission Processing, we will issue an update to the IRM detailing the procedures to use when referring cases to Adjustments. Additionally, we will ensure that the proper IDRS research training is provided to our CAS employees working this program.

IMPLEMENTATION DATE

February 1, 2004

RESPONSIBLE OFFICIAL

Director, Customer Account Services, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 3

The Director, Customer Account Services, SB/SE Division, should ensure that when Submission Processing Sites refer Forms 1120X to the Examination function, the appropriate action code is processed to each account to establish a record of the referral.

Processing Changes Would Enhance Service to Taxpayers Filing Amended U.S. Corporation Income Tax Returns

CORRECTIVE ACTION

The Director, Customer Account Services, SB/SE Division will ensure that procedures reflect the input of the appropriate action code prior to referring the Forms 1120X to the Examination function. We will provide guidance that addresses this particular situation.

IMPLEMENTATION DATE

February 1, 2004

RESPONSIBLE OFFICIAL

Director, Customer Account Services, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

If you have any questions, please contact Pete Stipek, Director, SB/SE Customer Accounts Services, Submission Processing at (859) 669-5557, or John Crawford, Director, SB/SE Customer Account Services at (972) 308-7010.